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The G20 and Monetary Policy Stasis*

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Since the financial crash of 2008, monetary policy has been in a state of stasis — a condition in which things are not changing, moving or progressing, but rather appear frozen. Interest rates have been frozen at low levels for a considerable period time. Inflation targets have consistently been missed, through phases of both overshooting and undershooting. At the same time, a variety of unconventional monetary policies involving asset purchases and liquidity provision have been pursued. Questions have been raised from a variety of sources, including various international organizations, covering distinct positions taken by the Bank for International Settlements (BIS) and the International Monetary Fund (IMF) about the continuing validity and sustainability of existing monetary policy frameworks, not least because inflation targeting has ceased to act as reliable guide for policy for more than six years. Nonetheless, central banks have been reluctant to debate moving to a new formal policy framework. This article argues that, as an apex policy forum, only the G20 summit has the necessary political authority to call its members' central banks to account and initiate a wide-ranging debate on the future of monetary policy. A case is made for convening a monetary policy working group to discuss a range of positions, including those of the BIS and IMF, and to make recommendations, because the G20 has been most effective in displaying international financial leadership, when leaders have convened and made use of specialist working groups.

Key words: G20; monetary policy; inflation targeting; central banks; Bank for International Settlements; International Monetary Fund; quantitative easing

Introduction

Since the financial crash of 2008, monetary policy has been in a state of stasis. Interest rates have been frozen at low levels for a considerable period time, while inflation targets have been consistently missed, through phases of both overshooting and undershooting. Most central banks around the world continue to have a formal commitment to an inflation target, but inflation targets have ceased to act as a reliable guide or anchor for policy. Monetary policy regimes have not been functioning as intended, as central banks have repeatedly missed their inflation targets. At the same time, a variety of unconventional monetary policies involving asset purchases and liquidity provision have been pursued. Questions have been raised from a variety of sources, including various international organizations, about the continuing validity and sustainability of existing monetary policy frameworks. Crucially, in many settings, short-term interest rates have appeared frozen at close to a zero rate. In the early stages of responding to the 2008 crash, many central banks saw inflation creep above their targets. In more recent times, inflation has commonly fallen well below the standard 2% target, falling to 1% and below. Consequently, interest rates cannot be cut and used as an expansionary measure. Monetary stimulus is exhausted and has probably reached its limits. At the same time, inflation targeting also provides no basis for raising rates, as the current data suggest it is falling in most major jurisdictions. Meanwhile,

* The editorial position does not necessarily reflect the authors views.

fears about the adverse effects of rate rises on large scale and widespread indebtedness compound policy caution, while debt continues to grow and financial asset prices remain inflated.

The net impact is that monetary policy has effectively been paralyzed as a tool of macro-economic management, beyond asset-purchasing policies, which are positions that are now beginning to be unwound, as they have reached their limits. The overall result is that monetary policy is in a state of stasis, – a condition in which things are not changing, moving or progressing, but rather appear frozen. Moreover, central banks have been reluctant even to begin a debate about moving to a new formal policy framework, despite considerable evidence that current formal monetary policy frameworks have ceased to act as a reliable guide to policy. In this regard, G20 leaders and their finance ministers could usefully use the G20 mechanism to instigate opening up this debate on what the monetary policy frameworks of the future should actually look like.

Part of the inertia, or stasis, in the field of monetary policy is an assumption that eventually monetary policy would return to business as usual, with a medium-term focus on price stability and low inflation. To date this has not materialized. Six years on from the crash, it is now time to question this assumption. The paradox is that while on a day-to-day basis conventional monetary policy appears frozen, the fact that existing policy frameworks appear redundant suggests that monetary policy on a broader level is entering a period of flux and change is in need of a fundamental rethink. Central banks themselves have had few institutional incentives to reopen debates about monetary policy, because inflation targeting was an integral component of hard-won independence. Despite this, evidence is growing that inflation targeting, at least in its current form, is unsustainable as a guide for policy and that monetary policy has effectively been paralysed as a policy tool in a number of systemically significant jurisdictions. This article considers the politics of this monetary policy stasis and considers what role the G20 can play in overcoming this stasis and in prompting and instigating a rethink in monetary policy.

This article begins by providing an account of this monetary policy stasis. Second, it contrasts the change in assumptions that have occurred in the field of financial regulation evident in the rise of macroprudential regulation with the relative inertia and stasis in monetary policy. Third, a number of the current criticisms of inflation targeting regimes are recounted, and an emerging BIS position is distinguished from an IMF position. Finally, the role the G20 can play in overcoming this stasis is examined through the lens of accountability and how the G20 as an apex policy forum can call central banks to account and initiate a wide-ranging debate on the future of monetary policy, discussing why it makes most sense for the G20 to do this collectively rather than for national governments to go it alone [Baker, 2010; Baker and Carey, 2014]. Only the G20 summit process possesses the necessary political authority for this task. A case is made for convening a monetary policy working group to make recommendations, as the G20 has been most effective in displaying international financial leadership, when it has convened and made use of specialist working groups.

Global Challenges

Following the financial crash of 2008, the certainties of inflation targeting have disintegrated. A focus on price stability provided no guarantee against major financial and macroeconomic instability in the period leading up to 2008. Central banks responded by reaching well beyond interest-rate policy, aggressively deploying their balance sheet in a variety of “unconventional” asset-purchasing policies. The line between monetary and fiscal policy has consequently blurred at precisely the time when public sector debts ballooned, due to the macroeconomic slowdown induced by the crash and the use of sovereign funds to bail out or support ailing financial institutions. Central banks’ ability to maintain inflation within stated ranges, and to avoid deflation (particularly in the euro zone), is being increasingly questionable by a range of voices, notably

the IMF. At the same time, Claudio Borio of the BIS has been critical of some of the underlying assumptions behind current monetary policy frameworks, arguing that current macroeconomic models provide little guidance to ward off and anticipate financial crisis, with the crisis exposing a chasm between theory and the practice of policy [Borio, 2011a, b].

During the 1990s and in the lead-up to the crash of 2008, a narrow view of central banking had taken hold. The focus was on the attainment of price stability through inflation targeting and a belief in the self-equilibrating properties of markets. Four propositions were at the core of this pre-crash consensus [Borio, 2011b]. First, price stability was seen to be sufficient for macroeconomic stability. By stabilizing inflation over the medium term on two-year time horizons the economy was believed to take care of itself. Second, there was a view that monetary policy and financial stability could be run as separate policy areas so that monetary policy would take care of price stability, while supervision would focus on the soundness of individual institutions as a route to financial stability. Moreover, this was increasingly handled by a separate regulatory authority, rather than by the central bank. Analytically, the behaviour of the financial system and markets was separated from macroeconomic models, which ignored long-run financial cycles over a 15- to 20-year period, and largely discounted financial instability and malfunctioning markets. Third, short-term interest rate adjustments were seen to be the primary monetary policy instrument and sufficient for monetary policy to play its stabilization role in relation to the wider economy. This was based on rational expectations assumptions about the future path of interest rates that dismissed the possibility that central banks might drive interest rates to zero and largely discounted the Japanese experience. Fourth, these premises were accompanied by the doctrine of keeping one's own house in order. This was the macroeconomic equivalent of the microprudential approach in financial regulation that suggested making sure each individual institution was sound and would translate into system-wide financial stability. In the global macroeconomic equivalent, countries replaced individual institutions and the world economy substituted for the financial system. All a central bank had to do was to ensure price stability in its own economy and let the exchange rate float (although it was conceded small open economies could benefit from pegging their exchange rates).

In the post-crash period, there have been signs of change. First, low inflation is no longer recognized as a guarantor of macroeconomic and financial stability. Low inflation, low yields and an apparently low risk environment actually encouraged greater private risk taking and rising leverage in the period leading up to 2007–08. Second, interest rate easing is not sufficient to clean the debris left by the financial crash. Central banks have consequently deployed their balance sheets to influence broader financial conditions by purchasing government and private sector assets and by providing liquidity to the banking sector. Finally, there has also been a macroprudential ideational shift. Now regulation focuses on the financial system as a whole, and not just on individual institutions, while recognizing the procyclical tendencies of financial markets and credit provision, the propensity for herding among investors, and the fragility and instability induced by financial complexity in a highly inter-connected financial system [Baker, 2013b]. Central banks have been given new powers to implement countercyclical policy instruments, such as countercyclical capital buffers, countercyclical liquidity requirements, loan-to-value ratios and limits on real estate lending. Macroprudential policy is a far more interventionist effort on behalf of central banks to curb financial and credit cycles. In short, it involves using prudential measures for macroeconomic means, although the process of building such policy regimes has only just started [Haldane, 2014]. Intellectually, this macroprudential position represents a Gestalt flip from the pre-crash consensus, which, in the words of Adair Turner [2011] chair of the United Kingdom's Financial Services Authority (FSA), derived from a simplified version of the efficient markets hypothesis, and had become part of the institutional DNA justifying light-touch assessments of banks' own risk management models.

By and large, central banks have continued to cling to the view that monetary policy should focus on price stability, with financial stability the focus of macroprudential policy. In other words, the siphoned, siloed nature of monetary policy and financial stability has persisted after the crash. Moreover, these two areas are, in the words of one BIS official who played a leading role in instigating the macroprudential ideational shift, is now characterized by “completely different languages and assumptions and this situation is untenable.”¹

One interpretation is that the crash of 2008 produced a “balance sheet recession,” with global implications. Monetary policy becomes less effective in a context of a balance sheet recession composed of over-indebted agents and barely functioning banking systems. In this context, current monetary policy frameworks are not functioning in the way intended. Many central banks have persistently missed inflation targets with interest rates at close to zero, while the spectre of deflation (or very low inflation below the target) hovers over the euro zone. Monetary policy is also effectively immobilized by the problem of debt overhang, which causes policymakers to worry about the potential social damage and dislocation caused by raising interest rates, while lowering rates brings no real prospect of increased economic activity among over-indebted agents. This paralysis is at the heart of monetary policy stasis. There are further worries that an extraordinarily accommodative monetary stance masks the debt problem, disguising the capacity of households and businesses to service debts. Furthermore, there is a concern that financial intermediaries such as insurance companies and pension funds are having their margins squeezed by persistently low interest rates [Borio, 2011b]. The BIS [2014] has urged its central bank members to exit loose monetary policy, highlighting the risks of normalizing too late. The BIS analytical lens focuses on balance sheets and the financial cycle, and warns that monetary policy has prioritized rescue operations at the expense of curbing and dampening booms [Jones and Fleming, 2014]. Low interest rates have also weakened currencies, which, although playing a role in economic recovery by boosting exports, also results in the spread of easy money to emerging markets through resistance to exchange rate appreciation, leading to imported inflation and growing fears of currency wars and competitive devaluations, and other beggar-thy-neighbour policies in the form of rising protectionism.

In short, monetary policy is in a state of paralysis or stasis. From a range of quarters, there is a growing dissatisfaction that current policy frameworks have outlived their usefulness. However, change and reform cannot be effectively undertaken by national authorities acting alone and in isolation, not least because financial imbalances take a global form and to do so would be to repeat the mistakes of the micro fixation of the doctrine of keeping one’s own house in order. Moreover, many minds, sharing experiences and mutual learning have epistemic advantages in enlarging the pool of information on which to make informed decisions and also prevent states from moving into the difficult territory of moving alone in adjusting and challenging the status of their independent central banks.

The Macroprudential Ideational Shift and Monetary Policy Stasis

Previous experiences of significant financial and economic crises have led many political economists to associate such moments of distress with significant ideational change [Blyth, 2002; Widmaier, Blyth and Seabrooke, 2007; Hall, 1993]. Since 2008, ideational change has been most evident in the emergence of macroprudential regulation [Baker, 2013b, a]. A macroprudential perspective questions and overturns much of the pre-crash orthodoxy. It involves a system-wide focus and treats financial risk as endogenous, or the result of the collective behaviour of institutions. Credit conditions, asset prices and the macroeconomy are seen to depend on the

¹ Confidential interview with official, February 2014.

behaviour of the financial system as a whole. The aim is to make calculations of risk for the system as a whole and establish solvency standards for the system, before working back from that to derive standards for individual institutions. Macroprudential analysis can be separated into two dimensions – a time dimension (how aggregate risk evolves over time) and a cross-sectional dimension (how risk is allocated and located within the system at a given point in time). The time dimension is linked to the concept of procyclicality and the notion that a macro financial cycle exists as a crucial source of instability. The cross-sectional dimension relates to inter-linkages between institutions that result in joint failures and vulnerability to common sources of risk. To address procyclicality, the principle is to build up buffers in good times, as aggregate risk grows, so that these buffers can be drawn down in bad times, as that procyclicality materializes. To address common exposures and inter-linkages, the principle is to calibrate prudential tools with respect to the contribution of each institution to systemic risk, once a given level of acceptable risk for the system as a whole is selected. In more expansive versions of macroprudential regulation, the dangers of cross-sectional vulnerabilities also bring greater calls for separation between commercial and investment banking, with ring fencing at the minimal end of the spectrum.

Policy has taken major strides in the macroprudential direction [Baker, 2013b, a]. The international community has strongly endorsed the need to establish macroprudential frameworks [Financial Stability Forum, 2009; High-Level Group on Financial Supervision, 2009; G20 finance ministers and central bank governors, 2009]. International regulatory bodies have been strengthening the macroprudential orientation of their standards, and national and supra-national authorities have been setting up new bodies with explicit macroprudential responsibilities. A lot of work is underway to establish how best to implement the arrangements. Monitoring and limiting systemic risk is now a core policy objective. The analysis of bank capital and liquidity requirements by the Basel Committee on Banking Supervision (BCBS) was informed by a top-down assessment of costs and benefits to overall output in Basel III. The BCBS has also introduced a countercyclical capital buffer. The capital buffer is accumulated during periods of “excessive” credit expansion, which could signal the build-up of systemic risks, and is released at times of incipient financial stress. The aim is to limit the amplitude of the cycle, acting as a dragging anchor during the upswing and releasing capital at times of stress to constrain downward movements and cushion landings.

Macroprudential analysis draws closer to an older tradition, which saw financial instability as an inherent property of an economy reflecting the close link between the financial and business cycles. This strand was best exemplified in the post-war work of Charles Kindleberger [1996] and Hyman Minsky [1982], which remained marginal in terms of the pre-crash orthodoxy. The work on procyclicality, in particular, was rooted in economic mechanisms that were almost entirely absent in the mainstream macroeconomic literature. The foundational assumptions behind prudential policy are now completely different to the pre-crash period. The propensity for endemic endogenous financial instability is now widely acknowledged and the equilibrium (and efficient, rational) properties of financial markets are widely questioned. Financial instability and the financial cycle are now considered to be key drivers of macroeconomic performance and underperformance. Regulation is seen to be a system-wide undertaking, needed to contain systemic risk rather than focusing on the stability of individual institutions.

It is instructive to observe this ideational shift. It was rapid and radical. BIS officials such as Claudio Borio, Philip Lowe and William White had tried to push macroprudential thinking in the pre-crash period, and undertaken important foundational conceptual work. They met with limited success and disinterest, bordering on hostility from central banks. Alan Greenspan was reported to be particularly unimpressed with macroprudential arguments [Balzli and Schiessl, 2009]. Others at the United States Federal Reserve responded that risk went up and

down.² At the Bank of England, Governor Mervyn King was so focused on monetary policy and his inflation mandate that he gave little attention to financial stability issues. The bank's financial stability team was largely marginalized in terms of the mainstream functions of the bank. This team did, however, conduct some in-house work that was sympathetic to the thrust of BIS arguments, in the mid 2000s, but chose to keep this work private because there was little audience for the work both inside and outside of the bank.

All this meant that when the crash reached its critical point in the autumn of 2008, there were already voices making the macroprudential case within the central banking community to whom G20 leaders turned for technical guidance and advice. Moreover, those figures within the central banking community who had been quietly developing a macroprudential perspective now had an opportunity to push the arguments and concepts that had been summarily dismissed as being unnecessary during the great moderation. Now their arguments looked retrospectively prescient and the crash itself appeared to provide substantial supportive empirical evidence for the perspective. Recognizing that the crisis provided the moment to push their arguments, BIS officials embarked on a concerted and energetic advocacy campaign, forming alliances with academic economists such as Charles Goodhart, John Eatwell, Hyun Song Shin, Martin Hellwig and Markus Brunnermeier. They were joined by more vocal and supportive UK officials, both at the Bank of England and the FSA, and at the Bank of Canada and crucially the Reserve Bank of India, as well as the Bank of Spain, all of whom had some limited prior experience with macroprudential policy instruments [Baker, 2013b, a].

However, it was the BIS as the provider of central banking services and analysis for its client national central banks that had become the spiritual home of macroprudential analysis and argument during the first decade of the 2000s. The BIS is an unusual institution in that it primarily provides data and analysis to its member central banks. Unlike the IMF, it does not provide a service such as the provision of emergency liquidity and financing packages. This means that states seek to exercise less control of its analytical and intellectual work than would be the case in the case in the IMF, giving the BIS a greater degree of intellectual freedom and autonomy that is largely accepted by the central banks.³ However, at the same time, central banks have greater freedom to ignore BIS analysis, as it does not come as part of a conditionality package attached to financial assistance, which is the IMF's primary form of leverage. Much of the work the BIS conducted on macroprudential came in response to the Asian financial crisis. BIS officials led by Borio were determined to promote macroprudential thinking. They were assisted by the appointment of Jaime Caruana as general manager of the BIS in early 2009. As former governor of the Bank of Spain, which was the only developed country central bank to have operated countercyclical capital buffers with some success, Caruana supported the macroprudential agenda. Moreover, he quickly recognized that establishing the approach would require getting it onto the G20 agenda, through the range of summit initiatives taking place during 2009. BIS officials were successful in doing this. For one BIS official, the key breakthrough in cementing the macroprudential approach came with the publication of the G20's Working Group on Enhancing Sound Regulation and Strengthening Transparency [2009] on 25 March 2009.⁴ The working group was co-chaired by Rakesh Mohan of the Reserve Bank of India and Tiff Macklem of the Bank of Canada, and made several recommendations calling for authorities to be equipped with macroprudential policy instruments. In this sense, G20 support was essential to give political momentum to the approach. Following the report, support for a macroprudential perspective was repeated in the London and Pittsburgh summit communiqués.

² Confidential interview with official, February 2014.

³ Confidential interview with official, Basel, February 2014.

⁴ Confidential correspondence, January 2012.

This support subsequently shaped and influenced the analytical work stream of the BCBS, the BIS itself, the IMF and the new Financial Stability Board (FSB).

Crucially, the macroprudential case is a very good example of what the G20 does best. It can endorse, approve, legitimate and initiate new approaches, principles and philosophies, and in doing so – as the apex economic policy forum in the global system – it shapes the agendas, priorities and timelines of other more expert bodies in global governance and simultaneously empowers them by establishing agendas and priorities [Baker, 2010; Baker and Carey, 2014]. In this sense, this is an example of the G20 as an apex policy forum presiding over a trajectory change in global financial governance, or sea change in broad approach. The G20 is able to do this by conferring its authority and approval to new ideas and approaches, in a way that can change the direction of travel in a particular policy field. This type of authority and endorsement can only come from the leaders' level [Eccleston, Kellow and Carroll, 2013]. The macroprudential ideational shift was an example of such a policy change that could not have occurred without G20 approval and support from the highest levels of government, but also from those at the pinnacle of finance ministry and central bank hierarchies. It is possible to argue that the G20 and Group of Eight have been presiding over a similar sea change in the tax case discussed by Dries Lesage in this issue. A further example has arguably come with the initiation of a Mutual Assessment Process (MAP), which intensifies the monitoring of global imbalances and acknowledges the globally interdependent nature of contemporary macroeconomic policy, with national authorities needing to be more aware of how one another's actions impact on the overall global picture, including the negative feedback effects that can occur from the "go it alone" or "putting one's own house in order" approach. This process also came out of a G20 workshop on sustainable growth and applies many macro insights from prudential policy to the G20 macroeconomic debate [Butler, 2012].

While the G20 has continued to monitor regulatory agendas, its big post-crisis governance contribution has been in presiding over this macroprudential ideational shift. This was a direct consequence of the G20's capacity to instigate and endorse such ideational shifts or sea change moments that only it, as a process, has the ultimate authority to oversee and signal. What was equally marked after the crash was how little movement and agreement there have been on how monetary policy should be changed to reflect these new insights from the macroprudential perspective. In contrast to significant and fast-moving change in the field of regulatory prudential (financial stability) policy, monetary policy has been characterized by ideational inertia (Baker, 2014). Overall policy frameworks, despite barely functioning, have not been overhauled. Extensive experimentation with unorthodox policy measures in the form of quantitative easing have not been accompanied by revision of either the pre-existing intellectual framework or the overarching policy framework [Baker, 2014]. Some six years on from the crash, inflation targeting in its current form seems barely tenable as a guiding policy target or frame. Notably, there has been no significant G20 discussion of monetary policy frameworks despite mounting discontent and questions about their viability.

There are reasons to believe that central banks themselves have had incentives to keep a discussion of monetary policy frameworks away from the G20 agenda. For BIS officials, the readiness of central banks to accept a new macroprudential policy framework is partly explained by their reluctance to change their monetary policy frameworks.⁵ In other words, from a central bank perspective the introduction of a macroprudential tool kit would address financial stability issues, taking the pressure off monetary policy and freeing it to focus on price stability. Central banks have prospered from current thinking in monetary policy because having operationally independent central banks meeting inflation targets was largely justified by the assumption that

⁵ Confidential interview with official, February 2014.

it was necessary to counter time inconsistency by signalling “good future intentions” to rational economic agents [Balls, 1998]. Moreover, senior central bankers have invested much of their careers in rationalizing and developing inflation targeting regimes, including formal modelling. They were not keen to ditch these framework after the crash, or even to open a debate about reconsidering them. However, as evidence of anomalies in existing frameworks mounts and accumulates, so pressure on central bankers to change tack is growing and to re-evaluate monetary policy frameworks.

Two Critical Perspectives on Current Monetary Policy

Two emerging distinctive positions on future monetary policy frameworks appear to be competing with one another. One of these is a BIS Austrian/early monetarist position, and the second a softer monetary Keynesian IMF position. The BIS position is slightly more nuanced than it first appears. The starting premise is that monetary policy cannot focus exclusively on the control of short-run inflation, but has to systematically take financial cycles into account. In this regard, the BIS analysis calls for tightening monetary policy to restrain the build-up of financial imbalances, in a pre-emptive fashion, even if near-term inflation is contained [Borio, 2011a, b; BIS 2014]. This entails extending the policy horizon beyond two years and examining a wider balance of financial risks. The BIS position is for these risks to be assessed in terms of joint deviations of credit and asset prices, especially property prices, from historical trends. From the BIS perspective, this involves identifying the symptoms that raise serious risks for the macroeconomy. This perspective is accompanied by a claim that equilibrium notions such as natural rates of interest and unemployment are, in fact, fuzzy and much more difficult to measure, whereas ratios of credit to gross domestic product are relatively straightforward to operationalize. Because monetary policy sets the universal price of leverage in a given jurisdiction, it is viewed as an essential part of the tool kit for managing the financial cycle and avoids the possibility for regulatory arbitrage. Under its current reading, the BIS sees financial markets as extraordinarily buoyant because of ultra low monetary policy being pursued around the world, and argues that monetary policy plays a role in halting the rise in debt burdens around the world [BIS 2014; Jones and Fleming, 2014].

The BIS position essentially calls for a balanced approach in which all policies – monetary, fiscal and macroprudential – play a mutually supportive role in restraining financial booms in a form of hard countercyclical management of the system as a whole. The basic idea is for policies to be more symmetric across the boom-and-bust phases of financial cycles. Policies would lean more deliberately against booms and then ease less aggressively and persistently during busts of a balance sheet nature. Scarce ammunition could then be used more effectively to hasten the recovery, by providing more scope for monetary easing in busts, but also by limiting balance sheet disrepair during booms. The basic BIS position is that the financial cycle remains absent from current macroeconomic policy frameworks and this is like a play without its main character – Hamlet without the prince [Borio, 2011b]. While prudential policy (financial stability) has rediscovered the financial cycle, the same cannot be said of macroeconomic and monetary policy. This is what the BIS wishes to rectify.

Meanwhile, Olivier Blanchard [2010] and colleagues at the IMF have argued for a higher inflation target rising to 4%. Other IMF analysis has pointed out how excessive “lowflation” can be problematic for financially stressed countries, where it implies higher real debt stocks and real interest rates combined with less relative price adjustment and greater unemployment [Moghadam, Teja and Berkmen, 2014]. There is now a belief that advanced economies are far more likely to hit the zero lower bound limit of inflation, and remain closer to it than previously

believed, and that the economic costs of that constraint on conventional monetary policy are much larger than the pre-crisis conventional wisdom [Krugman, 2014]. Notably, less-than-previously-expected inflation increases the real burden of existing debt. There is, for example, a high correlation in the euro zone between high debt burdens and lower than expected inflation and even deflation. Low inflation delivers less exchange rate and price adjustment for countries with high debts. The basic proposition is that an inflation target that may have been defensible two decades ago is arguably much less defensible now. In January 2014, Christine Lagarde [2014], managing director of the IMF, warned that deflation was the ogre haunting the global economy. In contrast, the BIS [2014] considers the risk of persistent and outright falling prices to be low.

In short, there is widespread discontent with the current regime from various branches of analytical apparatus that underpins global financial governance, albeit from different perspectives. Nonetheless, intense resistance remains from central bankers to regime change, even after more than half a decade in which interest rates have been close to zero. Moreover, this resistance persists even in the face of mounting criticism and anomalies in what appears to be a largely redundant and non-functioning and immobilized existing policy framework.

G20 Commitments, Governance and Accountability

Monetary policy has not featured prominently recently on the G20 agenda. It was mentioned in only two of the four communiqués issued by the G20 finance ministers and central bank governors in 2014. Policy had to remain “accommodative” in the medium term, with an expectation that it would normalize in due course, reducing the global economy’s reliance on easy money policy [G20 finance ministers and central bank governors, 2014]. The thrust of the statement was non-committal and the very possibility that existing policy frameworks maybe flawed and problematic was not even acknowledged. Essentially, the G20’s stance on monetary policy has been to continue to muddle through.

Nevertheless, the perception that monetary policy is fundamentally broken remains a strong one and serious analytical work is demonstrating this in the wider institutions outside of the G20. One of the key patterns in global governance, as the macroprudential case illustrated, is that G20 diplomacy is not just about states trying to influence one or another, or the G20 itself trying to steer wider sets of institutions. It is also about experts trying to shape the G20 and obtain support, prestige, legitimacy, approval and profile for their own ongoing work. The current priority for BIS staff, who were so successful in moving the financial stability consensus, is to move the consensus on monetary policy in the same way. A form of advocacy campaign on monetary policy is already underway at the BIS.⁶ Part of this strategy will undoubtedly be to get the G20 to think more seriously about monetary policy. In the language of the BIS, the lessons learned in the area of financial stability need to be extended across to monetary policy and the two areas need to be much more closely linked and integrated.⁷ The latest reorganization at the Bank of England, with personnel swapped between monetary and financial policy committees, is a very partial attempted step in this direction, even if the bank’s own position is to persist with inflation targeting, with a recent analysis suggesting monetary tightening is still some way off due to the conflicting trends the British economy is displaying [Haldane, 2014].

Probably the most impressive and useful aspect of G20 governance to date has been its use of working groups. These expert groupings have forwarded innovative policy proposals since the financial crash. In terms of effectively advancing and moving the international consensus for-

⁶ Confidential interview with official, February 2014.

⁷ Confidential interview with official, February 2014.

ward, they have the best track record. G20 working groups were pivotal in forwarding both the macroprudential shift and introducing the MAP, which has at least allowed for more structured and sustained dialogue on the issue of global imbalances in accordance with an agreed analytical framework [Butler, 2012]. A G20 working group to discuss and prepare a report on the long-term future of monetary policy is urgently needed. At least then high-level international debate on monetary policy can move beyond muddling through statements and actions (such as so-called forward guidance in the British case) and hoping for the best. But without intervention and direction from the G20, including convening a working group with full representation from the IMF and the BIS and their very different analytical positions, the current stasis on monetary policy is likely to persist.

The G20 matters in global governance for its ability to initiate trajectory changes in global governance and catalyze new thinking. Central banks play a big role in G20 preparations and deliberations within the network of finance ministers and central bank governors, but are less involved in preparing for the summit process, which is handled mainly by the leaders' personal representatives – the sherpas – but with some input from finance ministers and their deputies. Left to their own devices, central banks will continue to stumble along in an experimental fashion in a belief that a return to the old pre-crash policy frameworks and approaches will come sooner rather than later. In a sense they have had an incentive to keep monetary policy off the G20 leaders' agenda. But, six years after the crash, with little sign of current policy frameworks returning to their originally intended function, the time has come for a fundamental review and brainstorming exercise about the future role of monetary policy. Evidence is mounting in that direction, but so too is pressure from those working seriously on monetary policy outside national central banks, at the IMF and the BIS.

The G20, with its high-level authority and its position as global apex policy forum with the involvement of leaders and finance ministers, should recognize the signals coming from these institutions. G20 members should effectively call their own central banks to account, by asking them to reflect systematically and collectively about what the last decade has taught them about monetary policy, and to discuss the analysis emerging from these institutions and report back. The summit process can do this by instigating a working group on the future of monetary policy. A full, frank, candid and – most crucially of all – pluralistic and evidence-led review of monetary policy is urgently needed. The G20 can and should instigate and preside over this. In this sense, the issue of how to call central banks to account is complicated by their apparent independence based on a delegation contract in which central banks are tasked with meeting an inflation target. Moreover, as a profession, central banking increasingly displays the characteristics of a phenomenon that Martin Marcussen [2006] refers to as “scientization” – a striking intellectualization of the world via formal analysis and mathematical abstraction. One of the consequences of this process of scientization is that central bankers make epistemic alliances with other members of the scientific brotherhood; their research departments finance their own scientific journals and conferences as scientific credentials enhance careers for central bankers who increasingly possess doctoral degrees in economics and engage directly with the scientific community [Marcussen, 2006, p. 9]. A further symptom is that central banks' organizational, territorial and cultural boundaries are blurring as co-equal central bankers work closely together from project to project [Marcussen, 2006, p. 10]. From this perspective, central banking increasingly consists of “knowledge communities,” or transnational epistemic clan structures constructed around inter-paradigmatic discussions about theory, methods and data. As central banking has effectively globalized in terms of how to construct knowledge and notions of best practice, so too must efforts to call central banking, as a transnational profession, to account and direct its activities. For these reasons, governments have limited capacity to go it alone.

Within the G20's series of overlapping networks, central bankers are clearly represented, but so too are leaders and finance ministers, which gives the G20 a capacity to instigate a review of current monetary policy practice, particularly at the leaders' level, where the central bankers are not involved. One view is that nothing the leaders say is binding for independent central banks. This maybe true of day-to-day policy matters, including setting interest rate policy, over which central banks do have operational control and independence. However, the overarching monetary policy framework of inflation targeting was created and approved by politicians. In this sense, the G20 summit as meeting of leaders with the input of finance ministers can call on the central banks and other expert groups to review current monetary policy frameworks and to report back, accounting for the current underperformance and considering proposals for change to those frameworks. In this way, the G20 and its political leaders can respond to the transnational nature of central banking and call constituent central banks to account, by instigating a reflexive appraisal of existing practice.

The G20 has also displayed considerable flexibility through its working group format [Baker and Carey, 2014], where it has been possible to extend membership to a wider range of experts and stakeholders. By convening a working group on monetary policy, the G20 can conduct a thorough review and reflection on contemporary monetary policy, which is not restricted to the central banks themselves, but would bring a range of competing expert voices to the table. This is particularly important in the current era because some scholars have speculated that an era of "central bank — led capitalism" has dawned, in which central bank interventions have gone beyond traditional function of lender of last resort in providing significant financial support to the financial sector, but have also had major distributive consequences and amount to a form of banker welfare [Bowman Erturk Froud et al., 2012–13]. Consequently, there is a strong case for arguing that their actions need to be subjected to social criticism and brought under political control harnessing central bank expertise for the social objective of better socialized debt management [Bowman Erturk Froud et al., 2012–13, pp. 486–76].

Conclusions

After the financial crash of 2008, monetary policy throughout most of the G20 has displayed the exceptional features of very low interest rates (close to zero in many cases), largely ineffectual and seemingly increasingly redundant inflation targets (with inflation first overshooting, then undershooting, targets) and a series of asset-purchasing policies to support heavily indebted institutions and financial systems. This article has argued that consequently monetary policy has appeared to be paralyzed with short-term interest rates frozen at record low levels and inflation targets persistently missed. Moreover, this situation has now persisted for six years. Monetary policy has been in stasis and unable to return to business as usual. In the meantime, questions have been raised by international organizations about the viability of the monetary policy status quo. Yet, in this context, central banks have remained reluctant to move formally away from inflation targeting, or to review the medium-term objectives of monetary policy. Central banks could, of course, be the most immediate losers from such a review. The G20 therefore have a role to play in calling their constituent central banks to account, by instigating a far-reaching review of monetary policy frameworks that considers what viable medium-term monetary policy frameworks would look like. The G20's post-crash policy successes have emerged from the authoritative findings of working groups, which have been successful in instigating crucial trajectory changes in financial regulation. As the BIS has noted, however, the lessons learned in financial regulation have not travelled to monetary policy, which has been characterized by muddling through rather than by systematic lesson drawing. A high-level technical debate

about the future of monetary policy is urgently needed. The G20 can and should instigate such a debate by convening a specialist working group on monetary policy. This would raise questions about greater democratic control of central banks at a time when their policies appear to have had clear distributive implications and would raise serious questions about their capacity to maintain political legitimacy.

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